No. 14901

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOHN PIERCE,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITIONER'S OPENING BRIEF.

JOHN G. SOBIESKI,
458 South Spring Street,
Los Angeles 13, California,

EDWIN J. DOTSON,
203 Bridger Street,
Las Vegas, Nevada,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

No. 14901

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JOHN PIERCE,

Petitioner,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITIONER'S OPENING BRIEF.

I.

STATEMENT OF PLEADINGS AND FACTS SHOWING JURISDICTION.

This is a Petition to Review an Order [R.* 250] of the Securities and Exchange Commission (hereinafter referred to as the Commission) made on August 16, 1955, denying Petitioner's application for registration as a broker-dealer. Petitioner, John Pierce, resides in Las Vegas, Nevada. [R. 210.] Section 25(a) of the Securities Exchange Act of 1934 (hereinafter referred to

---

*References herein are to the Transcript of Record which is in two volumes. The first volume is printed. The second volume, to save expense, binds the Recommended Decision of the Hearing Examiner, and the Commission's opinions in their original form. Pages within parts of Vol. II are indicated by a dash and then their number. Example: Page one of the Recommended Decision would be [R. 249—1].

as the "Act") (15 U. S. C. 78y) authorizes the Court of Appeals for the Circuit within which the "aggrieved party" resides to "affirm, modify and enforce, or set aside such order in whole or in part" upon application filed with the Court within sixty days after the making of the order complained of. The Petition for Review of the Order of August 16, 1955, was filed in this Court on October 14, 1955. [R. 247.]

II.
STATEMENT OF CASE.

On October 28, 1954, John Pierce, the Petitioner herein, filed an application with the Commission for registration as a broker-dealer.* [R. 3-8.] On November 5, 1954, the Commission ordered that a hearing be held at Los Angeles to determine whether the application for registration should be denied. [R. 9-19.] (As a result the application never became effective.)

A hearing was held in November and December, 1954, before the Hearing Examiner appointed by the Commission. (An Examiner with over twenty years' service as such.) Both sides elaborately briefed the case and on February 8, 1955, the Hearing Examiner filed his 44-page Recommended Decision which concluded that Pierce's application for registration should "become effective forthwith." [R. 249—43.] On August 16, 1955, without discussing *any* of the findings of the Hearing Examiner favorable to Pierce, the Commission entered an order

---

*Section 15a of the Act (15 U. S. C. 78(o)(a)) requires registration with the Commission of every broker and dealer who uses the mails in his business except one whose business is "exclusively intrastate". Such registration automatically becomes effective thirty days after filing the application therefor unless the Commission suspends or denies it after a hearing. (15 U. S. C. 78(o)(b).)

denying registration. [R. 250.] On October 24, 1955, the Commission denied a rehearing and denied request for oral argument. [R. 251.] This petition for review followed.

The order for hearing, dated November 5, 1954, as supplemented and amended from time to time by the Commission, made, in general, the following charges:

a. That since approximately January 1, 1951, Pierce had acted as a broker-dealer without being registered;

b. That during said period Pierce was guilty of fraudulent conduct in approximately six transactions;

c. That the financial statement filed by Pierce with his application understated his liabilities by approximately $3,000.

Pierce's position on these charges is, and was, as follows:

1. He did act as a broker-dealer without registration. (His application is to correct that.)

2. He was not guilty of fraud in any of the transactions. On this score the Hearing Officer found: "I find no dereliction of duty or violation of any of our Acts chargeable to the Respondent." [R. 249—32.] (The Commission's order found fraud in but one transaction.)

3. Respondent did omit $3,000 of liabilities from his balance sheet. He claims it was inadvertent; the Hearing Examiner so found [R. 248—38, 39] and found additionally he also inadvertently omitted an asset larger than the liability. [R. 248—36.]

Petitioner's view is that his conduct, in any event, doesn't warrant that he be forever denied registration,

as the Commission apparently intends. (Pierce has already been denied registration for over a year and a half.)

Furthermore, it is our view that the one case (out of several hundred transactions) in which the Commission found fraud was not a case of fraud.

The Commission's Opinion, as previously mentioned, fails to discuss *any* of the findings of the Hearing Examiner whose findings were favorable to Pierce. In addition, as will be pointed out in detail hereafter, the Opinion, wrongly, we think, describes as clear cut and certain that which the record (and the Hearing Examiner's Recommended Decision) shows was informal and uncertain. (Nearly three years elapsed between the transaction and the testimony about it.) Significantly, the Opinion omits reference to the favorable findings of the Hearing Examiner as to Pierce's "responsibility in dealing with his customers." [R. 249—31, 32.] (Pierce had offered to refund to a customer in one case where there was a misunderstanding and made a refund in another case where not legally obligated.) [R. 249—31, 32.] Significant, we think, is the Opinion's failure to disclose that Hayward, the customer in the sole case where it found fraud, was an experienced businessman [R. 64] who regards Pierce as honest [R. 93], who never made a complaint to the Commission [R. 88], and never even criticized Pierce.

It is fundamental that

> "The one who decides must hear." (*Morgan v. United States,* 298 U. S. 468, 481 (1936).)

In this case the one who heard (the Hearing Examiner) recommended for Pierce.

Furthermore:

> "The committee reports also made it clear that the sponsors of the legislation (the Administrative Procedure Act) thought the statute gave significance to the findings of the examiner." (*Universal Camera v. N. L. R. B.,* 340 U. S. 474, 496.)

It is our view that the record shows the Commission's Order wrongly fails to "give significance" to the findings of the Hearing Examiner favorable to Pierce.

III.
SPECIFICATION OF ERRORS.

A. The order of the Commission issued August 16, 1955, denying Petitioner's application for registration as a broker-dealer is based on findings which are contrary to the record and are not supported by the evidence.

B. Said order does not give proper weight, as required by law, to the Recommended Decision of the Hearing Examiner, who heard the evidence, which Recommended Decision was favorable to Petitioner.

C. The penalty imposed upon Petitioner, who has already been denied the right to earn a living as a registered broker-dealer for a period of over a year and a half, is cruel, unusual and excessive.

IV.
ARGUMENT OF CASE.

A.
Petitioner's Transactions With Earl B. Hayward Did Not Involve Fraud.

The stock involved in this transaction was stock of the Las Vegas Racing Corporation. By September of 1951 the money raised by the public sale of stock was exhausted and the race track was uncompleted. [R. 60.] In January, 1952, an involuntary creditor's petition was filed under Chapter X of the Bankruptcy Act. [R. 60.] In March, 1952, a trustee under Chapter X of the Bankruptcy Act was appointed and reorganization followed. [R. 61.] Although the track was completed the reorganized corporation failed in 1954. [R. 62.]

(1)
The Record Shows That There Was No Fraud.

Petitioner claims that the Commission's Opinion does not correctly summarize the facts. The details of the Hayward transaction are, as in all cases where fraud is charged, important. Petitioner believes the fairest way to present the details is to quote verbatim the anaylsis of it by the Hearing Examiner found on pages 11-24 of his Recommended Decision (with which Petitioner agrees). (Where the Hearing Examiner cited the typewritten transcript we have changed the references to the appopriate page of the printed record.)

> "Earl B. Hayward Transaction.
>
> The testimony concerning the Hayward purchases and sales of the Racing Association stock is confusing. Units sold and total amounts are in dispute. Paragraph IIB(a)(1) to (8) of the Commission's

order alleges that Respondent, in February, 1952, 'solicited and induced' Hayward to entrust to Respondent, for the purposes of sale, 1,000 units of Racing Association stock and that Respondent would sell a portion thereof at $3 per unit and the balance at $4 per unit. It is further alleged that Respondent sold the units at $6 each and converted a portion of the proceeds to his own use, causing Hayward to believe that the units had been sold only for $3 and $4 per unit. During the public offering of the Racing Association stock, Hayward purchased through Respondent 3,000 units for $15,000. Thereafter, Respondent inquired of Hayward if he wanted to sell any or all of this stock. Hayward said he was not interested. [R. 65-68.]

The evidence discloses that Hayward, who is 44 years of age, is a competent business man, owns and operates the oldest floor covering business in Santa Barbara, California, and employs some 50-odd men and uses 18 trucks in his business. He is also experienced in the building industry and can tell whether real progress is being made in building a race track. [R. 107-108.] In 1951, a friend of his, a Dr. Pierson by name, suggested to Hayward that they go to Las Vegas and look over the race track then under construction and buy stock in it if they liked it. Hayward went to Las Vegas and bought $15,000 worth of units (a unit consists of one share of preferred and one share of common stock at a price of $5 per unit) from Respondent, who was then a salesman for the underwriter. [R. 61-66.]

The evidence is clear, and I find, that Hayward was neither solicited nor induced to purchase or to sell these 1,000 units of Racing Association stock from Respondent, but on the contrary the testimony shows that it was through his friend in Santa Barbara, Dr. Pierson, that '* * * I became interested

in an investment of that type (referring to Racing Association stock), because he was subsequently interested in a like deal, and we went over there (to Las Vegas from Santa Barbara) together to look at the situation and to buy stock if we liked it, which we did, and we both (Hayward and Pierson) bought stock at that time. I bought * * * a thousand shares at that time.' [R. 65.]

Thereafter, in September, 1951, the race track, not having been completed and the issuer had spent all his money, a creditor's petition for involuntary bankruptcy reorganization under Chapter X of the Bankruptcy Act was filed in the Federal Court in Nevada in January, 1952. At a time shortly prior to these dates Hayward, with knowledge of the lack of progress being made in completing the race track, became dissatisfied with his purchase and asked Respondent if he would not sell some of his stock and get some of his money back, saying that he wanted to 'get all out that he could,' that he wanted to 'get $5 per share for them, what I paid for them' and that he was interested in 'getting out what I had in it.' [R. 68-69, 99-103.]

The evidence is clear that Hayward went to Las Vegas and after looking the race track over, decided to sell his Racing Association stock. He stated that he had become disturbed at developments at the track and the decision to sell at that time was his own. 'I drew my own opinion of the situation.' [R. 96-106.] Hayward said he decided to sell before it blew up. The Hearing Examiner asked him if he was able to independently draw a conclusion as to what progress was being made at the track in completing the facilities and he stated that he was really wised up on these things. [R. 107-108.]

Respondent was not responsible in inducing Hayward to sell his stock. The evidence shows that on at least one prior occasion Hayward declined to sell when Respondent asked him if he would like to do so and in the light of Hayward's own knowledge of construction business and his concern at the lack of progress being made in the completion of the track at Las Vegas, I conclude that Hayward made up his own mind to sell his Racing Association stock, and thereafter he and Respondent '* * * did settle on an agreed amount' for the stock.

Hayward testified [R. 99]:

'Q. When did you settle on that agreed amount? A. When I sent him (Respondent) the shares of stock through the mail. I sent him a thousand shares, and that was the agreement.

Q. What was your agreement? A. The agreement was that I was to get $3 for the first 200 shares and $4 for the balance * * *.'

Shortly prior to February 21, 1952, Hayward sent certificates for 1,000 units of Racing Association stock by mail from Santa Barbara, California, to Respondent at Las Vegas, Nevada. [R. 71; CX 6.]

Staff counsel contends that Respondent told Hayward that he could not sell the stock for $5 a share, but that $3 and $4 per unit was all he could get. [R. 115-122.] Hayward stated that he had no independent information concerning the price of the stock and that relying on Respondent's representations he, Hayward, agreed to sell 200 units at $3 per unit and the balance at $4 per unit. [R. 99-118.] Thereafter, Hayward said he considered himself bound by this agreement. Staff counsel contends that Respondent was to sell the stock for Hayward and not, as Respondent testified, he would buy the stock from Hayward. [R. 211-212.]

As a result of observing witness Hayward giving his testimony, I feel that he made little, if any, distinction as to the real meaning of the leading questions put to him by staff counsel. These leading questions should have been objected to as they had a tendency to lead the witness in a field in which he had little understanding as to brokerage terms and the result was to put words in Hayward's mouth. In referring to the vague oral agreement as to how much he wanted to get for this Racing Association stock which he was turning over to Respondent, he stated that after the agreement to get $3 a share for the first 200 and $4 a share for the remaining 800, that this was the arrangement which had been made and he was ready to stand by it. [R. 70-71.] As previously shown, he stated that the thing he regarded as important was the fact that they (Hayward and Respondent) had settled on an 'agreed' amount. [R. 99.] Hayward did not remember whether these figures had been suggested by Respondent or not. His specific reply was 'I don't recall actually * * * honestly I can't tell you.' [R. 105, 106.] Thereafter, Hayward stated that since he had an agreement with Respondent, he did not consider it any of his business what Respondent sold the shares for so long as he got $3 and $4 per unit. In fact, his precise testimony on this point is as follows [R. 97-98]:

'Q. And the oral arrangement was that you were to get $3 for 200 shares and $4 for the balance, is that correct? A. That is right.

Q. And that was irrespective of what Mr. Pierce (Respondent) would get for the shares, is that correct? A. That is right.'

The leading and suggested questions previously adverted to were improper in that there was no show-

ing that witness Hayward knew the difference between selling the stock to Respondent or having Respondent sell it for him. In the one instance here, there is a principal-dealer relationship and in the other, there is a broker-agency relationship, a distinction with a real difference. The legal responsibilities in the two different relationships are vastly different and distinct. Again, Hayward was hazy and indistinct in his recollections. This is not an unusual experience for an energetic and busy man engaged in his own business operations, yet on the other hand, Respondent, in forthright and unambiguous fashion, testified that he told Hayward that he 'would buy the stock from him.' Specifically on this point Respondent stated:

'Q. And can you tell us the conversation (relating to disposing of Hayward's stock)? A. Well, he asked if I could find or dispose of a thousand shares of his race track stock and * * *

Q. When you say shares * * * A. Units. Units of race track stock.

Q. And what did you tell him? A. Well, I said that I didn't know. * * *

Q. Was this something that you said to him? A. Yes. One week there would be a rumor that the stock was hard to get because somebody said that they would finish the race track and then the next week there would be a rumor that nobody would ever finish the race track and every other day there seemed to be a difference of opinion of whether the stock was desirable or not. However, I told him that I would buy the stock from him at the rate of $3 a share, a unit, for 200 units and $4 a unit for the balance of the 800 units. * * *

The Witness (Respondent): I said "Earl (referring to Hayward) this is net to you." I said "Is

that all right with you?" And he (Hayward) said "yes."' [R. 211-212.]

Hayward testified that Respondent stated in connection with this somewhat uncertain oral agreement [R. 69-70]:

'Hearing Examiner: What did he (Pierce) say to you and what did you say to him, as near as you can recall?

The Witness (Hayward): Well, of course, I wanted as much as I could get of what I paid for it out of the stock, and—but I think, as we talked, he said, "well, first, if I get you $3 a share for the first 200 shares and $4 a share for the 800 shares, that's what we will do."

And I agreed to that, and that's what the arrangements were that were made.'

Thereafter, Hayward again stated 'But the thing I think is important is the fact that we did settle on an agreed amount.' [R. 99.] And of further importance is his statement that he did not recall whether the figures of $3 and $4 per share had ever been suggested by Respondent.

As a result of reading all of Hayward's testimony, there is justification to conclude that his vague oral agreement to sell the stock to Respondent was such that he did not regard it as his business what the latter sold the shares for so long as he got $3 and $4 per unit. [R. 94-125.]

As an indication of the witness' confusion in his testimony, staff counsel Tucker asked the following leading questions and the witness gave the following replies [R. 95]:

'Q. Well, now, as I understand your testimony, in those letters, Mr. Pierce was to sell that stock for you? A. Yes, sir.

Q. You weren't selling it to him; he was to sell it for you, is that correct? A. Yes.'

One page away, at page 96, under further recross-examination, defense counsel Sobieski asked the following questions and the witness gave the following answers:

'Q. And as I understand it, your understanding with Mr. Pierce was that you were to get $3 a share for 200 shares, and $4 for the balance, is that correct? A. Yes.

Q. And as long as you got that amount, you were satisfied, is that correct? A. Correct.

Q. And you never asked Mr. Pierce what he sold it for? A. No.

Q. And he never told you? A. No.

Q. And you weren't interested in what he sold it for, is that correct? A. No.'

On pages 96-98, the following colloquy between defense counsel and the witness occurred:

'Q. * * * now, prior to the time you decided to sell these shares, Mr. Hayward, you had become disturbed over the developments in the tract, is that correct? A. Yes.

Q. So the decision to sell at this time was your decision, is that—the one that you had made? A. That's right.

Q. Made from your own study of the situation? A. My own calculation of what I had decided I had better do.

Q. Yes. A. Before it was really too late.

* * * * * * * *

A. So I drew my own opinion on the situation.

Q. Well, now did Mr. * * * when you say you drew your own conclusions, was this the result

of your investigation independent of Mr. Pierce? A. My own observation. I had been over there, yes.

Q. Yes and then after that, then you had this oral arrangement with Mr. Pierce, is that correct? A. That's right.

Q. And the oral arrangement was that you were to get $3 for 200 shares and $4 for the balance, is that correct? A. That's right.

Q. And that was irrespective of what Mr. Pierce would get for the shares, is that correct? A. That's right.'

The above conflicting testimony indicates the difficulty a finder of facts has in appraising the true situation involved.

Of some importance in arriving at a final determination as to what Hayward's attitude was in this transaction is the following colloquy, which occurred during the course of the proceedings [R. 102]:

'By Hearing Examiner:

Q. You said something a while ago about $3 and $4 per share, * * * "irrespective of what Mr. Pierce was to get for the shares." I think that was in answer to a question put to you by Mr. Sobieski, "$3 or $4 irrespective of what Mr. Pierce was to get for the shares." Was that your understanding? You didn't care whether he sold them for $10 or $20, just so you got $4, is that your testimony? * * * That is all I want to know. A. Yes.'

Commission counsel also states that at no time did Respondent disclose to Hayward the price at which he sold Hayward's 1,000 units to purchasers Fox and Ramlos at South Gate, California. As above shown, Hayward testified that he never asked Respondent what he had sold the shares for. If, in effecting these transactions with Hayward, Respondent acted as principal-dealer, and I find that he did,

there was no burden thrust upon him to make the voluntary disclosure to Hayward. Hayward's testimony that he did not care if Respondent sold the units at $10 or $20 per share overweighs any other verbal agreement between Respondent and Hayward which, at best, is uncertain and vague. The verbal agreement, as the result of its vagueness and uncertainty, is contrary to the greater weight of the credible testimony of the parties involved herein.

The Commission's order alleges that this transaction is a fraudulent one and that Respondent converted certain proceeds from the sale of these units to his own use. The facts which follow do not justify this conclusion.

I find, and the evidence shows, that Hayward, pursuant to the verbal understanding, sent to Respondent certificates for 1,000 units of the Racing Association stock on March 3, 1952, and that Respondent sent Hayward a letter enclosing a $600 payment for part of the shares [CX 1; R. 66-73.] By March 28, 1952, Respondent had sold all of Hayward's 1,000 units and had received a total of $6,000. On May 14th, Respondent sent Hayward a check for $800, which was dishonored for insufficient funds. [CX 3; R. 72.] This was also in part payment for the shares. Thereafter, Respondent made this check good in September, 1952. As previously shown, Hayward testified that some time prior to September, 1952, Respondent told him that he had sold the stock and that there would be a delay in paying Hayward the balance due Hayward. Hayward stated that it was agreeable to him since he knew he would get his money and he was willing to grant Respondent a delay in paying the balance of the money due him. [R. 84.] There is credible testimony that Hayward agreed to regard the money due him from Respondent as a loan. [R. 213-214.]

'The Witness (Pierce): My best recollection is that I went to Santa Barbara to give him (Hayward) the $800 for this check; it was very nearly around that date and I discussed the balance of the money with him there.

* * * * * * * *

Q. Now, at that time, did you have a discussion with Mr. Hayward? A. Yes, I did.

Q. And what is your best recollection as to what was said by you and by Mr. Hayward in this discussion? A. I explained to Earl that I wanted to borrow the balance of the money that he had coming to him and I asked him if it would be possible for me to do that and he said that it would be all right.

Hearing Examiner: How much was that balance, Mr. Pierce, do you recall it?

The Witness: $2400.

Hearing Examiner: That was what was left after you paid him the $800 in cash?

The Witness: $800 and $600.

* * * * * * * *

The Witness: That is right.'

This testimony should be compared with Hayward's above testimony in connection with this same transaction [R. 84]:

'Q. * * * Mr. Pierce talked to you either in person or over the phone, and in which he said that there would be a delay in paying you the balance of the money coming to you? * * * A. Yes, that's right.

Q. And what did you say to that, Mr. Hayward? A. It was agreeable to me. I knew I would get it.

Q. You were willing to grant him the delay, is that correct? A. Yes.'

No further payments were made to Hayward until about June, 1954, when Respondent paid him $200 and gave Hayward a note for the balance due of approximately $2,200. After the time of the giving of this note in June, 1954, Hayward, after consulting his attorney, executed a statement that all his claims against Respondent had been settled. [RX 1; R. 73-83.]

In the light of the aforementioned testimony, although contradictory in part and confusing and indecisive in other parts, I find that the evidence is insufficient to hold that Respondent converted to his own use any of Hayward's units of Racing Association stock, or the monies resulting from the sale thereof. Hayward is a competent, successful and shrewd business man. It appears that Hayward, regardless of some preliminary statements appearing in the record, was not actually concerned at what price Respondent sold his shares for. I cannot conclude that Respondent was acting as an agent in this situation. On the contrary, it appears, and I so find, that Respondent was acting as a principal and he was selling shares at a prior fixed and determined price. The mere fact that Hayward testified that he was 'satisfied' with the transaction and that he believed Respondent was 'honest' [R. 93, 96] and furthermore that he made 'no complaint' [R. 88] to the S. E. C. about this matter is of little significance, for if Respondent actually mislead Hayward and acted other than as a principal or dealer I would, without hesitation, conclude that the dealings involved a breach of confidence. Mr. Hayward is an experienced business man and the charges of fraud involved in this transaction, in the light of the record testimony, have not been proven.

> In conclusion, I find that Respondent did not act as an agent and broker for Hayward and that the evidence is insufficient to hold that he engaged in the sale of securities by manipulative, deceptive and other fraudulent devices in contravention of Section 15(c)(1) of the Exchange Act of 1934 and of certain rules thereunder, nor did he engage in acts, practices and any course of business which operated as a fraud and deceit upon the said Earl B. Hayward in willful violation of Section 10(b) of the Exchange Act of 1934 and certain rules thereunder."

The foregoing well-reasoned and judicial analysis of the record by an experienced Hearing Examiner, who heard the evidence, clearly shows there was no fraud. We adopt it as our argument.

(2)

The Contrary Findings of the Commission Are Not Supported by the Record.

(a) The Commission's Opinion found a mistatement as follows: Applicant represented "to Mr. H. in February, 1951 (*sic,* the Commission probably meant 1952) [R. 250—5] that he could not obtain $5 per unit for Racing Association stock although he knew that Mr. F. and his associates were definitely desirous of acquiring from him for $12,000 to $15,000 units at $6 per unit * * *" [R. 250—7.] Only by ignoring a large part of the evidence, and misstating or distorting the rest, can support be found for this finding. This finding rests solely on a vague statement by an unreliable witness, Mr. Fox.

The Hearing Examiner says this of Fox's testimony: "Mr. Fox, an elderly druggist, changed his testimony on many occasions and in consequence of these vacillations,

I attach little credence to his testimony. He appeared to be not only confused, but actually to know few of the details concerning this transaction." [R. 249—27.] With reference to the Terry Drilling Company transaction, occurring only a year before the hearing (and thus two years after the disputed statement) the Hearing Examiner says this: "The record discloses that Mr. Fox was hazy or unclear as to exactly what happened. He frequently used the expression 'I gained the impression' and the like in testifying." [R. 249—29.] "Most of these Fox statements appear to be his own indistinct conclusions—not facts which he remembers." [R. 249—30.]

Mr. Fox first referred to the statement in answering a question as to how much he told Pierce, in November, 1951, that he was willing to invest right then, that November.

> "Q. Do you recall how much you wanted to buy at that time? A. Mrs. Fox and I decided that we would probably—
>
> Mr. Sobieski: Object as calling for a conclusion from the witness, hearsay.
>
> Q. (By Mr. Tucker): Is there something you told Mr. Pierce about it? A. Yes.
>
> Q. All right, what did you say to him about it? A. We had decided we would allocate twelve to fifteen thousand dollars for stock in the Las Vegas Racing Association." [R. 154.]

Thus, if Fox did make such a statement to Pierce he was talking about how much money he was willing in November, 1951, to spend in November, 1951.

In January, 1952, an involuntary bankruptcy reorganization of the Racing Association was instituted. [R. 60.] In the face of such an event, Pierce could not have been

justified in relying on any verbal statement of Fox's intentions, made in November, regardless of how firm and clear cut they were, which these were not.

Pierce did make a sale to Mr. Fox in February, 1952. The circumstances of this sale show clearly that Pierce was not then acting on the alleged statement and at that time did not have any reason to do so. The sale was made pursuant to a specific request in February. Pierce's letter of February 21, 1952, to Fox states the stock was sent "pursuant to your request," and later, "pursuant to our telephone conversation." [R. 45.] Further, Pierce wrote, "Therefore, if you or any of your friends want any additional units, please advise me at your earliest convenience and I will attempt to purchase same for you." [R. 46.] Fox also mentioned this phone call in a somewhat vague sort of way.

> "Q. With respect to Exhibit 6 and prior to the receipt by you of Exhibit 6, did you have any conversation with Mr. Pierce about further purchase of stock in the Association at or about that time? A. Mr. Tucker, which is Exhibit 6?
>
> Q. The yellow one dated February 21. A. I see. Oh, yes, I talked to him.
>
> Q. When and where did you talk to him, to the best of your recollection? A. I think, I know I talked to him on long distance over the phone.
>
> Q. About when was that? A. It might have been along in June.
>
> Q. I was referring to at or about February 21. A. You mean regarding this?
>
> Q. Regarding that. A. Well, I must have talked to him a few days before February 21.

Q. Can you recall specifically? A. I can't, Mr. Tucker. That's three years." [R. 158.]

Thus, it appears that the stock Fox bought in February, 1952, was purchased in accordance with a telephone conversation that month and not pursuant to the alleged statement of November, 1951. The parties did not act on the alleged statement. Did they still believe it a valid statement of intentions? The sentence in Pierce's letter of February 21, 1952, to the effect that Fox should let him know if he wanted "any additional units" [R. 46] is eloquent testimony that they did not. Pierce does not say *when* you want any more; he says *if* you do. Note, that at this time Pierce had at least 500 more shares available [R. 41], and Fox's total expenditures were only $6,000. [R. 149, 163.]

Thus, the charge of fraud against Mr. Pierce for telling Mr. Hayward in early 1952 that the price of $5 per unit for 1,000 shares was not obtainable because he allegedly knew Fox wanted to buy $15,000 worth collapses as not supported by the evidence. We have shown that the evidence the statement was ever made was weak; that if it was made the witness testified it referred to how much he desired in November, 1951, to spend in November, 1951; and that all reliance which might have been placed on it in November, 1951, was destroyed by the bankruptcy proceeding against the Racing Association in January, 1952. We have further shown that Fox and Pierce in their next transaction (Feb., 1952) acted without reference to the statement and, in fact, in a manner indicating that it had never been made.

(b) The Commission's Finding that Pierce undertook to secure for Mr. Hayward the best price obtainable for Hayward's stock [R. 250—6] is contrary to the record. This matter was analyzed at length in the Hearing Examiner's Recommended Decision quoted above. He closely questioned Hayward on this after considering all the evidence, oral and documentary. The following question and answer appear decisive:

> "Q. (By Hearing Examiner): —Was that your understanding? You didn't care whether he sold them for $10 or $20 just so you got $4, is that your testimony? That is all I want to know. A. (By Mr. Hayward): Yes." [R. 102.]

If Hayward "didn't care" whether Pierce sold the shares for $10 or $20 so long as he himself got $4 per share it obviously couldn't be fraud for Pierce to sell the shares at $6. This is fully analyzed by the Hearing Examiner. But since the Commission's entire case rests on this point, this decisive testimony of the customer involved, ignored in the Commission's Opinion, deserves mention.

B.

The Error in the Financial Statement Was Not Wilful.

The facts are correctly set forth in the Hearing Examiner's analysis of the evidence, which analysis shows the omission wasn't wilful. Petitioner here adopts those findings [pp. 32-39] of the Recommended Decision as his argument, changing the page references to conform to the printed Record.

"Financial Statement.

Assets and Liabilities as of October 26, 1954.

The December 1, 1954 amendment to the Commission's order alleges that the statement of financial condition, dated October 26, 1954, filed with the Commission on October 28, 1954, as part of the application for registration, omitted liabilities in the amount of $3,000. Respondent listed miscellaneous liabilities at $500. The statement which he filed follows:

Financial Statement
of
John Pierce
October 26, 1954

Assets		
Cash	$ 3,000.00	
House and Furniture 1021 Bracken, Las Vegas	20,000.00	
Cadillac Automobile	5,500.00	
Jewelry & Miscellaneous	3,500.00	
Showboat Hotel Inc. Stock	2,100.00	
Total Assets		$34,100.00
Liabilities		
Mortgage on house	$ 9,000.00	
Mortgage on car	1,500.00	
Misc.	500.00	
Total Liabilities		$11,000.00
Net Worth		$23,100.00

State of California, County of Clark, ss.

John Pierce, being sworn, deposes and says: The foregoing financial statement is true and correct to the best of my knowledge and belief.

/s/ John Pierce
John Pierce

Subscribed and sworn to before me this 26th day of October, 1954.

Edwin J. Dotson
Notary Public in and for said County and State.
Seal My Comm. Expires 2/19/58

Commission's counsel contends that the statement of unsecured liabilities of $500, instead of $3,000, is a material misstatement and that it tended to conceal from the Commission the fact that the obligation to witness Hayward was still unpaid. Respondent concedes that the liabilities should be stated at $3,000, but that the omissions from the financial statement were inadvertent and not willful. He also contends that he inadvertently omitted from the statement a government lease and option owned by him of a value of at least equal to the omitted liabilities. Staff counsel urges that Mr. Burr, of the Los Angeles office, had previously told Respondent [R. 140] that there was outstanding a debt to Hayward in the amount of approximately $2,400 and that the omission was not an oversight and could, and should, have been corrected in the subsequent financial statement which was filed. He also urges that a financial statement appended to any application for registration is a public record and its use is not confined to the limited purpose of the Commission's own information, but that it may be relied upon by the public in determining, among other things, the amount of credit that

may be safely extended to the Registrant, or the extent to which transactions in securities or other transactions depended upon his current ability to respond financially should be entered into.

It should be noted at this time, however, that this is merely an application for registration and the public is not at this time relying on these statements. I shall discuss this aspect at greater length shortly. Respondent, during the course of the proceedings, recognized the necessity for filing a corrected statement. [R. 214, 215.] His testimony follows:

'By Mr. Sobieski:

Q. Mr. Pierce, with reference to the financial statement which is attached to your application for registration, the item of indebtedness shows under the heading of "Miscellaneous" the sum of $500. Do you intend to file an amendment to your application? A. Yes, I do, as soon as we get through with the hearing.

Q. And the correct figures should be approximately $3,000, is that correct? A. Yes, sir.'

Respondent, as aforesaid, forgot to include in the financial statement an asset consisting of a five-year Lease Under Small Tract Act covering five acres of land near Las Vegas, Nevada. [CX 35; R. 215.] This lease was sent to one Fox about August 25, 1953 as security for an obligation owed by Respondent to Fox, but it was not formally assigned. [R. 228, 229.] In the lease, there is a prohibition against assignment without the consent of the United States. It contains a further provision that the lessee may purchase the described land after one year from its date if he has complied with the terms of the lease and has made certain improvements on the land. [CX 35.] Respondent testified, and there is other evidence in the record indicating that this leasehold

interest could ripen into a fee interest by the building of a small inexpensive house thereon or by drilling a well at an estimated cost of $250. Respondent says he intends to take all necessary steps in short order to get the fee title to this lease. [R. 225-242.]

Assuming, without conceding for the time being, that this five-year lease is an asset which can be used in the financial statement, I find that properties, and interests in properties of this kind, are dealt in with some degree of regularity in the Las Vegas area and that interests such as these have substantial value if the property is well located. This tract is well located. Informed statements were made in the record that similar tracts in nearby areas were selling variously from $1500 to $2000 an acre.[4]

I find that when and if a small amount of money is spent to ripen the lease to this tract of land into a fee interest, that the property has a conservative value of at least $7,500.

Rule X-15B-8 requires that an application for registration as a broker-dealer be accompanied by a notarized report of financial condition in such detail as will disclose the nature and amount of assets and liabilities and the net worth of the broker-dealer, as of the date within thirty days of the date on which

---

[4]See Dotson's statement [237-242 and elsewhere] and other credible testimony [R. 216-217]. During the course of the proceedings, the Hearing Officer indicated that he proposed to visit and view the tract of land in question with an informed broker of the Las Vegas area. He did so, accompanied by Mr. Dave McCoig, a well known and respected Las Vegas real estate broker, and found the tract of land level, with no gullies or gulches, and located in the Paradise Valley area near the Race Track and not far from the famed Strip, the site of the famous hotels and gambling casinos, and also found that expensive residences were in use and under construction nearby. Mr. McCoig stated that the property had a value, in his estimation, of not less than $2,000 an acre and probably more. This estimate was based on recent sales, so he stated.

the report is filed. Ordinarily, applicants for registration are not engaged in business as brokers-dealers and consequently the net capital rule (X-15C3-1) is not applicable to them. However, the reports of financial condition are analyzed in the light of that rule, for the purpose of determining whether the applicant would be able to comply with it, if and when he commences business. This rule states that net capital shall be deemed to mean the net worth of the broker-dealer, that is, the excess of assets over liabilities adjusted by certain items, one of which is fixed assets or assets which cannot be readily converted into cash including, among other things, real estate less any indebtedness secured thereby.

Questions have arisen as to whether an applicant must show all of his assets and liabilities or only those relating to his broker-dealer business and the concensus seems to be that Rule X-15B-8 would ordinarily require a broker or dealer to disclose in his statement of financial condition the nature and amount of his assets and liabilities relating only to his business as a broker or dealer, provided, however, that if he has other assets or liabilities, not relating to his business and the excess, if any, of such liabilities over such assets would materially affect his net worth then he would be required to disclose also the amount of such excess.

For example, if an applicant has $3,000 in liabilities not relating to his broker-dealer business and $7,500 worth of assets not relating to his broker-dealer business, such assets and liabilities would not have to be disclosed because the liabilities do not exceed the assets. If, however, those liabilities are found to relate to his business as a broker-dealer failure to disclose them would be in violation of Rule X-15B-8. However, if they were disclosed, the ap-

plicant's net worth, as then shown, may not be materially different from that previously disclosed since he would be entitled to include in the report a sufficient amount of assets not relating to his business as a broker-dealer to offset the previously undisclosed liabilities.

On the basis of the balance sheet submitted as at October 26, 1954, and assuming that Respondent was subject to Rule X-153C-1, if the capital were computed according to Rule X-15C3-1, Respondent's capital would be $2,890 and his aggregate indebtedness $2,000, so that he would be within the requirements of the Rule.

On the basis of including in his assets the five-acre tract of land located in Paradise Valley, reasonably near the famous Strip in Las Vegas, where the well known hotels and gambling casinos are located, at a value of $5,000, and showing as liabilities an amount of $3,000, his net capital would be $390 and his aggregate indebtedness $4,500 and he also then would be in compliance with the Rule.

Rule X-153C-1 requires that the indebtedness shall not exceed 2000% on a broker's net capital.

Where we find a broker-dealer, whose financial statement, when submitted under Rule X-15B-8 in support of his application for registration, the analysis of which, based upon Rule X-153C-1 shows an impairment in capital, it is customary to alert the Regional Administrator in whose jurisdiction the applicant may be in, and have him require the applicant to make such changes in the financial statement as the circumstances seem to warrant.

At any rate, the financial statement as of the present date is inadequate. An amendment to the statement would be necessary to bring it into focus. Respondent so concedes and urges that it was through

inadvertence that the omission to list additional liabilities occurred. In the light of the foregoing, there appears to be insufficient evidence to justify a finding of willfulness within the purview of our statutes and I so find."

C.

The Public Interest Does Not Require Denial of Petitioner's Registration.

The findings on pages 39-43 of the Hearing Examiner's Recommended Decision properly develop this point. They are as follows:

"WILLFULNESS.

As previously set forth on pages 9 and 10 of these findings, I finally conclude that certain of the actions of Respondent in connection with his purchase and sale of securities for the account of others as a broker at a time when he was not registered with the Commission pursuant to Section 15(b) of the Act is willful. The reasons assigned therefor are set forth in footnote 3 on page 10. In engaging in such a course of conduct in the purchase and sale of securities by the use of the mails and other instrumentalities of interstate commerce, after having been admonished on several occasions by Mr. Burr, of the Los Angeles Securities and Exchange Commission office, that he should register, he displayed a somewhat callous disregard of the consequences of his acts and assumed the legal responsibilities arising from such conduct while he was engaged in the business as a broker and dealer without registration. In addition to the aforementioned cases defining wilfullness, the Commission, in several other cases, has defined this term and has generally taken the view that gross carelessness, heedlessness, callous and reckless disregard of the conse-

quences of one's acts, certain types of ignorance and indifference and culpable acts of omission are sufficient to justify a finding that Respondent's statutory violations are willful.[5] Even though he did not have a great many transactions in such capacity, nevertheless the transactions which he consummated were in violation of the Securities Act of 1933, as well as the Exchange Act of 1934 and the Commission's Rules and regulations thereunder. Other than the aforesaid willful acts, I do not find that any other willful violations have occurred.

Staff counsel urges that the weight of all of the evidence in these proceedings is such as to impel the conclusion that the public interest requires a denial of Respondent's application to register. Respondent, on the other hand, through his able counsel, urges that no penalty should be invoked in view of all of the circumstances in this proceeding, since Respondent has been exposed to a long and costly proceeding, that he has learned the errors of his ways and that these proceedings have forcibly impressed upon Respondent the necessity for being completely above board in the conduct of any securities transactions. It is further urged that the staff of the Commission has examined many of Respondent's transactions and they have come up with only six questioned ones and these have been shown to be not improper.

It is conceded that Respondent, for a period of time, operated as a broker and dealer. However, he now asks the opportunity to correct this and register with the Commission in order to be permitted to earn a living in the brokerage business.

---

[5] *Leedy, Wheeler & Co.*, 16 S. E. C. 299; *In the Matter of Rosenfeld*, S. E. C. Act Release No. 4656; *Securities and Exchange Corporation*, 2 S. E. C. 760.

PUBLIC INTEREST.

Even though Respondent may have been guilty of willful violation of certain provisions of the Securities Act, his application for registration as a broker and dealer may not be denied unless such action is found to be in the public interest.[6]

Denial, revocation or expulsion is a means of protecting the public interest against the activities of applicants, brokers and dealers who may violate the law. Its primary purpose is to prevent repetition of unlawful activities by denying the right of applicant, broker or dealer to make use of the mails and other instrumentalities of interstate commerce to effect transactions involving the purchase or sale of securities. In arriving at a final determination as to what action is required in the public interest in this case, I have noted the apparent sincerity of the applicant to do what is right and what may be required of him under our statutes hereafter. I have carefully observed the demeanor of the applicant and other witnesses who testified during these proceedings. I find much of the evidence susceptible to conflicting interpretations. While I have noted no deliberate attempt to mislead, nevertheless the memory of certain witnesses was hazy and at other times their testimony was downright confusing. In fact, direct statements made by certain witnesses at one time, especially the testimony given by Fox and others, were subsequently contradicted in part by themselves at a later time during the proceedings. In consequence, I have been obliged to carefully note the demeanor and forthrightness of all the witnesses at the time they were on the stand and my findings and conclusions have

---

[6]*Bond & Goodwin, Inc.*, Sec. Release No. 5343; *Van Alstyne, Noel & Co.*, 22 S. E. C. p. 180 (1946); *Ira Haupt & Co.*, 23 S. E. C. 606 (1946).

been arrived at on the basis of what I regard as reliable, probative and substantial record testimony. In doing so, I realize that the Commission is not limited by the strict rules as to the admissibility of evidence, which prevails in suits between private parties.[7] I have not been unmindful that the more liberal practice of admitting testimony (and such was the case here), the more imperative the obligation to preserve the essential rules of evidence by which rights are asserted or defended.[8] Findings of fact are often inferential in nature resulting from a conclusion to be drawn from a multitude of related facts. On the one hand, it has been necessary to weigh certain conflicting statements against the statements of others and to consider the evidence as a whole in arriving at a final determination as to whether the public interest requires that the Respondent be denied his broker-dealer application for registration.

Final Conclusion.

I assume that since the hearing in this matter in November, 1954, Respondent has not engaged in the purchase and sale of securities as a broker and dealer. In consequence, his application for registration has been deferred accordingly and will continue to be deferred until the present denial proceedings have been resolved. The question arises as to whether applicant should be permitted to fully escape the consequences of his own wilful acts when he was acting as a broker-dealer without being registered. Even though applicant concedes that he acted as a broker-dealer when he should have been registered with the Commission, and since his acts in this respect must be

---

[7] *I. C. C. v. Baird,* 194 U. S. 25.

[8] *I. C. C. v. Louisville and Nashville Railroad,* 227 U. S. 93.

viewed either as the result of deliberate or reckless conduct, I would ordinarily be inclined to find that some adverse action would be warranted under the circumstances, such as a denial for a short period of time, say for instance, thirty days without prejudice to his filing a subsequent application for registration. I do not, however, make this recommendation, for it would appear that Respondent has not only learned the errors of his ways, but these proceedings have been lengthy and costly and furthermore, since his application for registration has been postponed for a considerable period of time as a result of these proceedings, I conclude that the public interest would not necessarily be served by the imposition of any additional penalty. In the light of the foregoing, I do not find that the public interest requires a denial of his application to register. I find, however, that the public interest will be served by permitting this application to become effective forthwith."

D.

The Commission's Order Does Not Give Proper Weight, as Required by Law, to the Recommended Decision of the Hearing Examiner.

The decision of the Supreme Court in the leading case of *N. L. R. B. v. Universal Camera Co.,* 340 U. S. 474 (1951), reversed a decision of the Board that (as here) was inconsistent with the findings of the man who heard the evidence. The court stated:

> "The committee reports also made it clear that the sponsors of the legislation (the Administrative Procedure Act) thought the statute gave significance to the findings of the examiner."
>
> 340 U. S. 474, 496.

> "* * * on matters where the Hearing Commissioner having heard the evidence and seen the witnesses is best qualified to decide, the agency should be reluctant to disturb his findings unless error is clearly shown."
>
> 340 U. S. 474, 494.

This decision begins to face the facts of life so far as Administrative agencies are concerned. According to Professor Cooper of the University of Michigan Law School (consultant to one of the Hoover Commission Task Groups) it is the Securities and Exchange Commission's practice for the Commission *not* to read the record but to rely on a digest prepared by its staff. (41 A. B. A. Jour. 705, 707, Aug., 1955.) The learned professor comments that this practice:

> "Often, decision depends on the weight to be accorded conflicting testimony. It seems entirely likely that a carelessly prepared digest (or, much worse, a digest prepared with the *hope* of sustaining a finding supporting the Commission's contentions) might lead to a different decision than would be obtained if the digest had been carefully and accurately prepared—or if decision were made by one who had heard the witnesses, or read their testimony in full.
>
> This case, it is thought, illustrates the great difficulty that inheres where the members of the agency must rely on the judgment and judicial abilities of junior staff assistants to weigh the evidence."

It thus appears, in S. E. C. practice, that the Recommended Decision may be a mere straw man. The real "weighing of the record," according to the learned professor, apparently rests on the "judgment and judicial abilities of junior staff assistants." But counsel for the

aggrieved party never get to see this private memorandum on which the Commission's decision rests. It will be noted that, in the case at bar, the Commission's Opinion stated:

> "The hearing examiner recommended that the application for registration be permitted to become effective * * * Our findings are based upon an independent review of the record." [R. 250—4.]

Significantly, that was the final reference in the opinion to the Hearing Examiner.

Similarly, the Opinion did not mention the arguments in our brief. Pierce's counsel has never seen that "independent review" of the record. The Commission has not had the benefit of the comments of counsel for Pierce on the "independent review" on which Pierce's fate rests. This is the sort of procedure that Professor Cooper castigates. "The result is decision second hand, twice removed." (41 A. B. A. Jour. 705, 706.)

The Hearing Examiner, besides being a man of wide experience, acts publicly. Counsel are advised of his findings. Consequently it accords with American principles of justice that his findings, and not a private staff memorandum, should be the real basis of the decision.

We must never forget the principle that

> "The one who decides must hear."
>
> *Morgan v. United States,* 298 U. S. 468, 481 (1936).

It is recognized that it is difficult for agencies to be judicial in fact. Professor Schwartz, of New York University, writes:

> "But the purpose of securing truly independent judicial determinations is subverted by the possession

> by the agencies of executive functions. Agencies cannot be expected to decide cases before them with that 'cold neutrality of an impartial judge' of which Burke speaks when it is they who have instituted the proceedings against the private party, and they who have the burden of presenting the case against him."
>
> 69 Harv. L. Rev. 963 (1956).

It can be assumed that the Supreme Court was aware of these dangers to the judicial process when it ruled that the agency cannot ignore the findings of the Hearing Examiner. After all, he is the one man in the Administrative process who is in a position where he can act like a judge. A comparison of the Recommended Decision in this case with the Commission's Opinion shows, in his decision only, "the cold neutrality of an impartial judge."

In the present case the findings of the Hearing Examiner, favorable to Pierce, weren't even discussed in the Commission's Opinion denying registration. Apparently *no* weight was given to the Hearing Examiner's findings. This is contrary to law and to the decisions. The way for this Court to uphold the rule of law and the new importance of the Hearing Examiner, is to modify the Commission's Order so as to grant registration in accordance with the Hearing Examiner's recommendation.

E.

The Penalty Already Imposed on Pierce Is More Than Enough. Further Penalty Through Further Denial Is Unwarranted.

This point was covered thoroughly in the Hearing Examiner's Recommended Decision. Since then, however, Pierce has been denied registration for an additional year, which makes the argument for no further penalty all the more pursuasive.

The purpose of registration, we must assume, is to protect the investing public. But here there is no showing that the public now needs protection from Pierce. Although exhibits filed in the case showed that Pierce had engaged in several hundred transactions since 1951, the Commission now claims only one of these to involve fraud. (The Hearing Examiner found no fraud.) In that case, Hayward's, occurring in early 1952, the customer consented that the funds, which were not paid over, be regarded as a loan. Hayward, an experienced business man, who knew the facts, regards Pierce as honest. Furthermore, as the Hearing Examiner found, Pierce took a responsible attitude towards his customers. The Hearing Examiner pointed out that Pierce made a refund, in one case, although not required to do so, and in another case offered to do so when a misunderstanding apparently had occurred. The proceedings in this case have obviously cost Pierce several thousands of dollars. They have also been a liberal education to him as to S. E. C. regulations. There appears no proper basis for any inference he would injure anyone in the future. Pierce desires to register and comply with the S. E. C. regulations. It appears to us that further penalties, after a year and a half of suspension, would be arbitrary, cruel and unusual and not in the public interest.

V.
CONCLUSION.

The Commission's Order dated August 16, 1955, should be modified to bring it into accord with the Recommended Decision of the Hearing Examiner who heard, and understood, the evidence. Petitioner's application for registration should be ordered to be permitted to become effective.

Respectfully submitted,

JOHN G. SOBIESKI,
EDWIN J. DOTSON,
By JOHN G. SOBIESKI,
Attorneys for Petitioner.